



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
Washington, D.C. 20224

SMALL BUSINESS/SELF-EMPLOYED DIVISION

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MEMORANDUM FOR SBSE EMPLOYMENT TAX TERRITORY MANAGERS, GROUP
MANAGERS AND SPECIALISTS

FROM: John Tuzynski /s/ *John Tuzynski*
Chief, Employment Tax Operations

SUBJECT: Interim Guidance – Payments for Services Requiring Information Reporting

Information reporting is a key component in IRS compliance programs. Information reporting also serves to further several key initiatives in the administration of federal income taxes, such as reducing burdens associated with tax return preparation.

One of an examiner's core responsibilities is to perform a comprehensive "Package Audit." Internal Revenue Manual 4.23.3.7.3 (03-24-2009), Scope of Employment Tax Examination states:

1. It is recognized that examinations, whether change or no-change, vary in scope. Normally, the examiner is expected:
 - A. To conduct the examination to a point where the reported employment tax liability is determined to be substantially correct,
 - B. To determine whether information returns and wage statements have been correctly filed, and
 - C. To determine whether all applicable Federal returns requirements have been met.

Examiners need to be alert for situations where payments for services are inappropriately structured or incorrectly classified to negate the information reporting requirements.

Recently, the National Tip Reporting Compliance Program became aware of a payment for services requiring information reporting that was incorrectly being labeled as a tip. Because tips received in connection with employment are not subject to information reporting on Form 1099, the taxpayers making those payments were not reporting the payments to the IRS.

The situation identified involves payments to drivers of taxicabs, limousines, tour buses, and other modes of transportation. The drivers are employees of companies engaged in the business of transporting passengers for a fare. The drivers pick up and transport passengers to their requested destinations. Typically, the driver collects the fares from the passenger. It is customary for the passenger to tip the driver an amount in addition to the fare for the transportation provided.

Some adult entertainment clubs, restaurants, nightclubs, and other service establishments have a practice of making payments to drivers who bring passengers to their establishments. Generally, the service establishment's personnel will not render payment to the driver until the passenger first pays a cover charge or otherwise indicates in some manner that they are patrons of the service establishment. Payments are usually made in cash, although some establishments issue vouchers to the drivers that can be exchanged for cash at a later time. The amount of the cash or voucher payment may or may not bear any relationship to the transportation fare, may vary depending upon the number of patrons, and may be far greater than either the fare or the customary tip for the transportation. In many situations, one or more passengers are transported from a hotel directly to a service establishment. In some cases, the driver may make agreements with certain hotel personnel so that when a guest wants to go to an establishment, the hotel personnel will summon the driver from the hotel's transportation queue and the driver will split the payment from the establishment with the hotel personnel. In some cases the passenger may not request a particular destination and the driver or hotel personnel will recommend an establishment that will pay the highest amount for delivering the passenger/patron. Many establishments advertise in local magazines, specifically targeted at drivers in the transportation industry, that they will pay a "referral fee" or "tip" or "incentive" for delivery of passengers/patrons.

Generally, the drivers are not separately reporting the payments to their employer as tips and the employers are not treating the payments as wages subject to employment taxes and required to be reported on Forms W-2. The absence of reporting on either Forms 1099 or Forms W-2 may result in some drivers not reporting the payments as income on their income tax returns.

Per a Program Manager Technical Advice (PMTA) received from TEGE Counsel dated 12-01-2010, under the facts and circumstances described, the payments are not tips received in the course of employment with the transportation company, but are for services separate and distinct from those the drivers perform for their employer and, if the payments equal or exceed \$600 in a calendar year, should be reported on Forms 1099 filed with the IRS by the service establishment and also issued to the service provider, the driver. The facts and circumstances presented in the PMTA support the characterization that the payments at issue are for the drivers' separate and distinct service of referring patrons, influencing patrons, and delivering patrons to particular establishments, rather than merely transporting passengers as part of their duties for their employers. The fact that the payments from the establishments are generally contingent upon the "passenger" becoming a "patron," whether by entering the establishment, paying a cover charge, purchasing a ticket, meal, or other service is indicative that the payment is made for the separate service of delivering a patron rather than transporting a passenger. The service establishment is not the recipient of the transportation service; it is the recipient of the delivery of a patron. Furthermore, the fact that drivers frequently recommend the passenger's destination, sometimes in collaboration with hotel personnel, in order to secure the payment from a particular establishment further strengthens the conclusion that the establishments are paying drivers for bringing them customers, a service separate and distinct from merely transporting passengers to the passenger's requested destination.

When examining service businesses, examiners need to probe for the existence of payments of this type which are usually paid in cash or by a voucher that can be converted to cash at a later date. Various techniques should be used to identify the existence and deducting of such payments in the service sectors where this practice is common.

The reporting requirements applicable to the payments for services separate and distinct from the drivers' employment are provided in I.R.C. § 6041(a). This Section requires all persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of \$600 or more in any taxable year, to file an information return with the Service and to furnish an information statement to the payee. Payments are fixed when they are paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. Treas. Reg. § 1.6041-1(c). Payments that are fixed or determinable must be reported on Form 1099. Treas. Reg. § 1.6041-1(a)(2).

Because the payments at issue are for the separate and distinct services of delivering patrons, the service establishments are required under I.R.C. § 6041 to file a Form 1099 with the IRS for each person (driver) to whom they paid \$600 or more during the calendar year. If the establishments do not file Form 1099, examiners should consider assertion of penalties under I.R.C. § 6721. Penalty assertion should be discussed with the examiner's manager.

Backup withholding should also be considered. If the payor fails to secure a TIN from the service provider individual (driver), the payor is required to withhold 28% of the payment amount as backup withholding. See Section I.R.C. § 3406.

This guidance is effective immediately. If you have any questions, please contact Senior Policy Analyst Tammy Wise, Specialty Programs, Employment Tax, National Tip Reporting Compliance Program.

cc: www.irs.gov